MARKET COMMENTARY

2ND QUARTER 2019

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All major stock indices posted positive returns in the second quarter of 2019. The S&P 500 enjoyed its best first half of the year since 1997. However, to many investors, the quarter likely felt like a grind. The market was forced to overcome many obstacles to achieve its advance, including earnings reports, trade tensions, and market altering comments from the Federal Reserve. In the end, those investors with the greatest resolve and the ability to largely ignore day-to-day headlines reaped the benefit of these handsome returns by remaining invested in equities. Though we do not expect the equity markets to repeat the strong performance of the first six months of the year, in the second half of 2019 investors will likely be well-served to take a longer perspective and not base decisions on near-term market worries.

First quarter earnings, reported primarily in April, were subdued but generally exceeded investors' modest expectations. Many feared a slowing global and U.S. economy would adversely impact growth and earnings. Corporate earnings reports were also facing challenging year-over-year comparisons as the result of last year's strong results, which were partly driven by the tax cuts enacted in late 2017. Benefitting Riverbridge clients, companies demonstrating steady earnings growth were rewarded during the quarter.

Escalation of the U.S. – China trade war captured the attention of investors. In May, after trade talks appeared to have stalled, the United States imposed new tariffs and sanctions on China. These actions created uncertainty within the supply chains of many U.S.-based companies. This includes companies both selling into China and sourcing production in the country. Generally, those companies most insulated from the trade war performed best. Late in the quarter, the United States and China reached a short-term understanding, leading to some sanctions being lifted. However, a long-term agreement remains elusive.

Meanwhile, the Federal Reserve altered its posture with respect to interest rates. In June, the Fed signaled it is prepared to cut interest rates to support economic growth and to encourage inflation toward its two percent target. Many view this action as an admission that their December rate hike was ill-advised. Regardless, this signaled policy shift opens the door to future interest rate cuts, which was warmly greeted by investors. Should the Fed opt to lower interest rates, it would be the first time doing so since the financial crisis.

For the remainder of the year, both bulls and bears have plenty of ammunition to support their stances. Bears can point to struggling European economies and generally declining global growth as evidence corporate earnings will continue to be under pressure. According to FactSet, S&P 500® companies are expected to post modest year-over-year declines in earnings for the remaining two quarters of the year. The fears of an economic slowdown have pushed bond yields down globally. Remarkably, the yield on the 10-year U.S. Treasury closed the quarter at two percent, which represents a significant decline since the end of the first quarter. Furthermore, trade tensions and heated political rhetoric on the campaign trail will likely persist for the remainder of the year.

Bulls, in a similar fashion as the second quarter, may benefit from low expectations and skepticism among market participants. Given this backdrop, the chance that investors are positively surprised by market shaping actions has increased. With accommodative global central banks and low levels of inflation, the ingredients for a conducive economic environment remain in place.

> Riverbridge encourages its clients and readers to largely ignore market headlines. They are generally not helpful in enabling investors to achieve good long-term results.

We invest in companies and management teams that are adept at traversing macro-economic uncertainty. Our portfolio companies have positioned themselves for endurance, with conservative balance sheets featuring low levels of debt and defendable strategic market positions which provide them the ability to navigate uncertain markets. Regardless of the market backdrop, the Riverbridge investment team will not depart from our time-tested investment disciplines.